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IN THE

Supreme Court of the United States

OCTOBER TERM, 1948.

No. 151

NATIONAL CARBIDE CORPORATION,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

No. 152

AIR REDUCTION SALES COMPANY,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

No. 153

PURE CARBONIC, INC.,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

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PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

To the Honorable the Chief Justice and Associate Justices of the Supreme Court of the United States:

Your petitioners, NATIONAL CARBIDE CORPORATION, AIR REDUCTION SALES COMPANY and PURE CARBONIC, INCORPORATED, hereby respectfully request this Honorable Court to issue writs of certiorari to the United

States Circuit Court of Appeals for the Second Circuit to review the decision and judgments of that Court which reversed the decisions and orders of The Tax Court of the United States in these proceedings.

The Tax Court, thirteen of the sixteen judges concurring, had set aside determinations by the Commissioner of Internal Revenue of deficiencies aggregating $1,066,253.10 in the 1938 corporation income and declared value excess profits taxes of petitioners.

Opinions Below.

The opinion of the Circuit Court of Appeals (R. C, 1-9) is reported in 167 F. (2d) 304.

The findings of fact and opinion of the Tax Court (R. A, 5-36) are reported in 8 T. C. 594.

Jurisdiction.

The judgments of the Circuit Court of Appeals were entered on March 31, 1948 (R. C, 10, 12, 14). A petition for re-hearing was filed on April 15, 1948 (R. C, 16-21), and was denied, without opinion, on April 19, 1948 (R. C, 22, 24).

The jurisdiction of this Court is invoked under Section 240 of the Judicial Code as amended by the Act of February 13, 1925. After September 1, 1948, this will be Section 1254 of Title 28, United States Code.

Questions Presented.

The questions presented are as follows:

1. Where no question of "sham" or of "disregard of corporate entities" is involved, may a subsidiary

corporation be the agent of its parent so that the income from its operations is properly taxable to the parent, as the Tax Court has held?

2. Whether this Court's decision in *Southern Pacific Co.* v. *Lowe*, 247 U. S. 330, "still stands", as decided by the Tax Court, or is "no longer controlling", as decided by the court below?

3. Should legal effect be given to express agency contracts between subsidiaries and their parent, which were always followed in all respects in all operations between them?

4. Can a Circuit Court of Appeals properly reverse a decision of the full bench of the Tax Court in which the Tax Court expressly found and held that subsidiaries "were corporate agents" of their parent, and that the income from their operations "belonged to and was the income and property" of the parent "as principal"?

Statutes and Regulations Involved.

These cases do not involve the construction or application of any specific statutes or regulations bearing directly on the issues.

Summary Statement of Facts.

The facts found by the Tax Court (R. A, 5-28) establishing the agency relationship, may be summarized as follows:

Each of the three petitioners was a wholly owned subsidiary of Air Reduction Company, Incorporated,

commonly known and herein sometimes referred to as "Airco" (R. 7*). Airco, the parent company, was engaged in the manufacture of gases and equipment for gas and electric-arc welding, cutting and heat treatments of metals. It utilized the three petitioners in three related branches of its business.

The Operating Contracts.

With each petitioner, Airco had an express operating contract. These contracts follow the pattern established on March 1, 1917 in the contract between Airco and Air Reduction Sales Company (R. 11-12).

In each contract Airco agreed to give each subsidiary the use of all gas cylinders and containers, trucks, equipment and shipping facilities which it owned; to supply each subsidiary with working capital; and to provide executive management and office accommodations and facilities for each (R. 12).

All assets held and used by the three subsidiaries were furnished to them by Airco which had paid for them with its own cash or by exchange for Airco's stock. All working capital was supplied by Airco (R. 21, 31).

In consideration of Airco furnishing these assets and services, each contract provided, among other things, that the subsidiary should "credit monthly on its books to Airco all profits accruing to it from the operation of its entire business over and above an amount equal to six percent. (6%) per annum of its outstanding capital stock" (R. 12-13).

Some of the salient facts found by the Tax Court, in addition to those relating to the operating con-

* References are made to the Findings of Fact of the Tax Court, printed in Part A of the Record.

tracts, which establish that the business of Airco was conducted through its subsidiaries as agents, were:

Board of Directors.

The Airco Board held regular meetings, determined the general policies, and completely controlled the business of Airco and each subsidiary (R. 22, 28, 31).

Directors of the subsidiaries, with one minor exception, were all senior officers of Airco. These Boards held an organization meeting each year and thereafter met only to formalize action taken by the Airco Board (R. 28, 30, 31).

Officers.

The officers of the subsidiaries were the officers of Airco and they exercised complete control, administration and management over the business of each of the subsidiaries in accordance with the policies and directions of the Airco Board (R. 21, 22, 31). Airco maintained one general office in New York for all companies (R. 20, 22).

Branches of the Business.

The business of Airco and the subsidiary companies was divided into six main branches, each headed by an officer of Airco. All employees in these branches performed their duties whenever and wherever required in connection with the operations of all companies (R. 22-23, 31).

Bank Accounts.

Bank accounts in the names of the subsidiaries were drawn upon by Airco indiscriminately whenever cash was needed for its own use or for any subsidiary no matter in whose name the account was kept (R. 25-26, 32).

Accounting.

All accounts were kept strictly in accordance with the operating contracts. The value of all assets held and used by each subsidiary, all working capital furnished to it and the net proceeds from its operations in excess of its compensation under its contract, were credited to the accounts payable by the subsidiary to Airco and were debited to the accounts receivable by Airco from the subsidiary. No interest ran on any of these accounts (R. 21, 27, 32).

There were no inter-company profits (R. 25, 31-32). None of the subsidiaries declared dividends (R. 27). The proceeds realized from the operations of the subsidiaries went to Airco by reason of its method of operation and accounting under the operating contracts (R. 32).

Tax Returns.

During 1938, as in prior years, Airco reported all income from its operation of the subsidiaries, in excess of the nominal amount of each subsidiary's contract compensation, as its own, and paid taxes thereon accordingly (R. 10). The method by which Airco conducted its business and all details of the relationships between it and its subsidiaries were always fully disclosed to the Government and to the Commissioner (R. A; 28).

Adjustments made by the Commissioner.

In 1938, for the first time, the Commissioner disregarded the operating contracts and long established pattern of Airco's operation, eliminated from Airco's return the amounts credited to Airco on the books of each subsidiary and increased the income re-

ported by the three subsidiaries by these amounts (R. A. 5-6). The result was a large deficiency, which is in net effect almost wholly one of Declared Value Excess Profits Tax, resulting from attributing substantial incomes to the subsidiaries while giving them no benefit from the capital stock tax declaration of the parent.

Had Airco known that the Commissioner would change his position and refuse to accept for 1938 and later years Airco's method of reporting income, which he had accepted in prior years, Airco could properly have made different capital stock declarations for itself and its subsidiaries, thus removing any possibility of a claim for Declared Value Excess Profits Taxes.

Decision of the Tax Court:

In the Tax Court the proceedings were tried before Honorable Eugene Black and reviewed by the entire court. Thirteen judges concurred in the decision; only three dissented and they without opinion.

The Tax Court stated that the issue before it was:

> "* * * Whether, as the respondent has determined, the income from the operations of the three petitioners belonged not to Airco, the parent, but to the petitioners and was taxable to them; or whether, as the three petitioners contend, the income from the operations of the petitioners in 1938, exclusive of the small amounts paid to petitioners under the contracts, belonged and was taxable to Airco, the parent company, both because the petitioners were in fact incorporated departments, divisions or branches of Airco's

business and because the petitioners operated pursuant to express contract with Airco" (R. A, 28-9).

On all the evidence, the Tax Court's finding of ultimate fact was that:

> "Petitioners were the *corporate agents* of Airco and were operated as incorporated branches or divisions of Airco. The income from the operations of petitioners which is in excess of six per cent of petitioners' outstanding capital stock belonged to and was the income and property of Airco as principal" (R. A, 28; italics ours).

Therefore, the Tax Court held: "That there are no deficiencies in income tax and declared value excess profits tax for the calendar year 1938." (R. A, 4-5).

Decision of the Circuit Court of Appeals.

The opinion below erroneously assumed that the Tax Court had merely held that the subsidiaries "were operated as branches or divisions" of Airco and that the Tax Court had, for that reason alone, held that their net income was taxable against Airco and not against the subsidiaries. It completely disregarded the express contracts and the agency relationship found as a fact by the Tax Court, saying:

> "'Airco' found it more convenient in its manufacture and distribution to adopt a quadripartite form than to deal directly with third persons itself. Whatever its reasons, they were business reasons, and the corporations it used were 'corporations' within any interpretation of the law. That is enough; it must accept the consequences

of that choice; and it is not material that it retained the direction of their affairs down to the minutest detail, that it provided them with their assets, that it stood back of their liabilities and took all their profits" (R. C, 8).

The Tax Court had cited *Southern Pacific Co.* v. *Lowe*, 247 U. S. 330, as "aptly descriptive of the relationship" between petitioners and Airco (R. A, 30). But the Circuit Court of Appeals after discussing *Moline Properties, Inc.* v. *Commissioner*, 319 U. S. 436, said:

> "Even though *Southern Pacific Co.* v. *Lowe*, *supra*, set up a different test, we regard it as *pro tanto* no longer controlling" (R. C, 8).

Specification of Errors to Be Urged.

The Circuit Court of Appeals erred:

1. In holding that a subsidiary corporation cannot be the agent of its parent so that the income from the operations of the subsidiary is in law, as well as in fact, the income of the parent.

2. In holding the decision of this Court in *Southern Pacific Co.* v. *Lowe*, 247 U. S. 330, to be "*pro tanto* no longer controlling".

3. In failing to give legal effect to clear and bona fide operating contracts between the subsidiary corporations and their parent under which the subsidiaries became agents of their parent, and in failing to hold that the amounts payable to the parent under the contracts are the income of the parent, as principal, taxable to it.

4. In exceeding its powers of review by reversing the Tax Court which had expressly found and held that the subsidiaries were "the corporate agents" of their parent and that the income from the operations of the subsidiaries "belonged to and was the income and property of Aireo as principal".

5. In failing to hold, if the income is to be treated as belonging to the subsidiaries, that amounts payable by the subsidiaries to Aireo pursuant to bona fide operating contracts were deductible as ordinary and necessary business expenses of the subsidiaries or, in the alternative, in failing to remand the proceedings to the Tax Court for the determination of that issue.

Reasons for Granting the Writs.

1. The decision of the Circuit Court of Appeals is in conflict with the decision of this Court in *Southern Pacific Co.* v. *Lowe*, 247 U. S. 330, and with the direct implication of this Court's decisions in *Moline Properties, Inc.* v. *Commissioner*, 319 U. S. 436, and in *Interstate Transit Lines* v. *Commissioner*, 319 U. S. 590.

The court below treated the case as one involving the "disregard of corporate entity". But this ignores the real question here which is whether the existence of the agency relationship, expressly found by the Tax Court, is to be given its legal effect.

The court below decides that such an agency relation cannot be effective as a matter of law. This decision is in conflict with *Southern Pacific Co.* v. *Lowe*, *supra*, which likewise involved close relations between a subsidiary and a parent. There the subsidiary, as this Court said in *Peabody* v. *Eisner*, 247 U. S. 347,

349, decided the same day, acted "merely as its [the parent's] agent and subject in all things to its direction and control". The present case is also one of agency, as the Tax Court clearly held.

After quoting language from *Southern Pacific Co. v. Lowe*, 247 U. S. 330, to the effect that there the subsidiary acted as agent of its parent and was completely controlled by it, the Tax Court said (R. A. 30):

> "We think the foregoing words of the Supreme Court are aptly descriptive of the relationship which existed between petitioners and their parent, Aireo, in the instant case."

A little later it said (R. A. 32):

> ". . . We think, however, that when all these facts are viewed together they bring petitioners within the rule announced by the Supreme Court in *Southern Pac. Co.* v. *Lowe*, *supra*."

Finally, the Tax Court referred to the fact that the Commissioner had accepted returns from the taxpayers for the years 1935, 1936 and 1937, on the basis for which they now contend, and concluded (R. A. 36):

> "* * * Nevertheless, we think that his apparent interpretation of the law in 1935, 1936, and 1937 as it affected petitioners was correct and that the rule announced by the Supreme Court in *Southern Pac. Co.* v. *Lowe*, *supra*, still stands."

It is clear, therefore, that the full bench of the Tax Court regards *Southern Pacific Co.* v. *Lowe* as still law in cases of agency, and that it considered the present case to be a case of agency. But, the Circuit Court of Appeals refused to follow the *Southern*

Pacific case. It indicated (R. C, 5) that the *Southern Pacific* decision is one which the Supreme Court "is not willing any longer to treat as authoritative," and added (R. C, 8):

> "* * * Even though *Southern Pacific Co.* v. *Lowe*, *supra*, set up a different test, we regard it as *pro tanto* no longer controlling."

Thus, the Circuit Court of Appeals expressly rejects the decision of this Court in the *Southern Pacific* case, by which the full Tax Court had been guided.

The continuing validity of the *Southern Pacific* case within the field of actual agency relationship has been recognized by this Court in recent decisions. Thus, in *Moline Properties, Inc.* v. *Commissioner*, *supra*, which was heavily relied upon by the court below although its facts were wholly dissimilar, this Court had expressly pointed out (p. 440):

> "* * * There was no actual contract of agency, nor the usual incidents of an agency relationship."

In the present case, there were contracts of agency; all the usual incidents of agency relationship were present; and the Tax Court expressly found that the petitioners were "the corporate agents of Airco" (R. A, 28).

Likewise, in *Interstate Transit Lines* v. *Commissioner*, 319 U. S. 590, this Court said (p. 593):

> "This is not the case of a mere branch or division of a business conducted solely for convenience's sake under a separate corporate form."

In that case, this Court pointed to the absence of an important relationship, present in this case, in which the Tax Court has expressly found that the "Petitioners . . . . were operated as incorporated branches or divisions of Airco" (R. A, 28).

Furthermore, the decision of the Circuit Court of Appeals, gave no effect to the express operating contracts between Airco and its subsidiaries, and is in conflict with the implications of the decision of this Court in the *Interstate Transit Lines* case.

In that case, in both prevailing and minority opinions, this Court clearly recognized that a bona fide contract between a parent and a subsidiary should be given effect. The decision of the majority, opinion by Mr. Justice Reed, assumed the validity of the contract, and disallowed the claimed deduction only upon the ground that the subsidiary was engaged in a business which its parent, Interstate, could not legally do.

But, Mr. Justice Jackson in his dissenting opinion (Chief Justice Stone and Mr. Justice Murphy concurring) called the agreement between the two corporations a "commonsense business arrangement."

The operations in the present case were pursuant to contracts which originated in 1917, and which have remained unchanged and in full force from their inception to the present time. The Tax Court found that the method by which Airco conducted its business through corporate agencies was consistently adhered to, and that all details of the relationship between Airco and each of these subsidiaries were fully disclosed to the Government and the Commissioner (R. A, 11, 12, 20, 28).

Thus, the decision below erroneously rejects *Southern Pacific Co.* v. *Lowe*, and applies recent decisions of this Court to a factual situation which was expressly excepted in those decisions. *Southern Pacific Co.* v. *Lowe* has never been overruled, and the above-quoted language from the *Moline Properties* and *Interstate Transit* opinions was undoubtedly intended to preserve its applicability in the field of agency.

2. The Circuit Court of Appeals exceeded its powers of review and so far departed from the accepted and usual course of judicial procedure in like cases as to call for the exercise of this Court's powers of supervision and correction.

At the time this case was decided below, the decision of this Court in *Dobson* v. *Commissioner*, 320 U. S. 489, was in effect. It has since been abrogated by the amendment to Section 1141(a) of the Internal Revenue Code which was made by Section 36 of the Act of June 25, 1948.* This development emphasizes the importance of review in the present case.

As we have shown, the issue below was whether an agency relation existed between the subsidiaries and their parent. That issue was basically one of fact to be determined upon the evidence. The case was tried at length before the Tax Court, and it expressly found that "Petitioners were the corporate agents of Airco", and that "The income from the operations of

* That section, as amended effective September 1, 1948, reads as follows: "The Circuit Courts of Appeals . . . shall have exclusive jurisdiction to review the decisions of the Tax Court . . . in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury; . . ." (Public Law No. 773, 80th Congress, 2nd Session).

petitioners . . . belonged to and was the income and property of Airco as principal" (R. A. 28).

Under the *Dobson* rule, as it was effective when this case was decided below, we believe it entirely clear that the findings of fact and decision of the Tax Court should not have been interfered with by the Circuit Court of Appeals. The same conclusion should follow under the statute as it has now been amended. That statute directs that Circuit Courts of Appeals shall have the same power in reviewing decisions of the Tax Court as in reviewing "decisions of the district courts in civil actions tried without a jury."

This Court had established the rules of review in such cases before its decision in the *Dobson* case. For example, in *McCaughn* v. *Real Estate Land Title & Trust Co.*, 297 U. S. 606, this Court held that a Circuit Court of Appeals might not review a decision of a district court on the issue of contemplation of death, which involves a mixed question of law and fact. Similarly, in *Wilmington Trust Co.* v. *Helvering*, 316 U. S. 164, where the issue was whether certain sales were short sales or ordinary sales, this Court reversed the Circuit Court of Appeals, which had reversed the Board of Tax Appeals. It said (316 U. S. at 168):

> "It is the function of the Board, not the Circuit Court of Appeals, to weigh the evidence, to draw inferences from the facts, and to choose between conflicting inferences. The court may not substitute its view of the facts for that of the Board. Where the findings of the Board are supported by substantial evidence they are conclusive."

Therefore, whether this case is regarded as coming under the *Dobson* rule, or under the scope of review as now applicable, the decision below was erroneous in that the Court exceeded its powers of review.

It is especially important in view of the abrogation of the *Dobson* rule that this Court announce anew the limitations on the scope of review of Tax Court decisions which basically involve only questions of fact.

3. We urge upon this Court that when there is a conflict between a Circuit Court of Appeals and the *full bench of the Tax Court,* on an important question in the tax field, the resolution of such conflict should, *prima facie,* be regarded as a matter of great public importance, justifying the grant of a writ of certiorari. This is particularly true where, as here, the conflict between the two courts is with respect to the controlling force and effect of a decision of this Court.

The relation of this Court to tax cases has long been one of concern. The system of waiting for conflicts to develop between Circuit Courts of Appeals has led to great delay in the final resolution of tax questions, and to uncertainty and confusion while the conflicts were developing. A system which leaves important tax questions *in limbo,* often for many years, until an appellate conflict develops has been overwhelmingly demonstrated as unsatisfactory and unsound.

Moreover, the tendency of Circuit Courts of Appeals to treat each case coming before them as *res nova,* and to decide each case independently of the

decision of the Tax Court can only create confusion and uncertainty. Although the *Dobson* case no longer stands, the problem vitally affecting the public interest still remains.

We do not urge that this Court should review every decision of a Circuit Court of Appeals reversing the Tax Court. Many of the decisions of the Tax Court are memorandum decisions by a single judge, and many others, though published, are likewise the decisions of a single judge. Only a small proportion of the decisions of the Tax Court are "Reviewed by the Court", as was the decision below (R. A. 36). These are ordinarily the cases which the Tax Court itself deems of exceptional importance and upon which it feels that the judgment of its entire membership should be brought to bear. In the present case we have a decision which is important, not only because it was by the full bench of the Tax Court, but because it deals with a tax question of wide and general interest and is consistent with the current of the decisions of the Tax Court over a period of years.*

The Tax Court is the great basic tribunal in tax cases. Nearly 90% of all tax cases are heard by the Tax Court. It has not merely a specialized jurisdiction, but a specialized experience and competence in tax cases. Its jurisdiction is not confined to one Circuit but is nation-wide. A conflict of decisions between *the full bench of the Tax Court* and a Circuit Court of Appeals presents, *prima facie*, a question of

* See, for example, *Custom Casing Co.* v. *Commissioner*, T. C. Memo. op. Docket Nos. 102719, 102721-4; 1943 C. C. H. Dec. No. 43194-M; 2 T. C. M. 58, which involved almost identical facts; *Seminole Flavor Co.* v. *Commissioner*, 4 T. C. 1215 (1945); *Baxter Machinery Co.* v. *Commissioner*, T. C. Memo. op. Docket Nos. 7780, 8950; 1947 C. C. H. Dec. No. 15908-M; 6 T. C. M. 806.

as great public importance as a conflict between two Circuit Courts of Appeals. Unless such a reversal in a case involving an important tax question is reviewed, confusion and uncertainty will permeate the tax field, with consequent tremendous waste of judicial and administrative time and energy. We will continue the system to which an experienced commentator referred when he wrote:

> "Meanwhile a confused Bureau and bewildered taxpayers, who would be quite content to adjust themselves to the first decision if it were left unchallenged, are forced to struggle along as best they can until the Supreme Court selects one of the available alternatives. . . ." Surrey, "Some Suggested Topics in the Field of Tax Administration", 25 Wash. U. L. Q. 399, 419.

Particularly now that the *Dobson* rule has been abrogated by statute, this Court would take an important step in carrying out its responsibility for the orderly and effective administration of justice if it would promptly recognize the grounds for granting writs of certiorari which we here urge.

If the decision below be permitted to stand, the legitimate business operations of many corporations will be open to attack. Every corporation carrying on operations with subsidiaries may find—as these taxpayers now find—that its entire system of business procedure has been overturned.

Should corporations rely on the decision below or on that of the full bench of the Tax Court? A decision of this Court would eliminate that uncertainty. Taxpayers will be able to adjust their business pro-

cedures in accordance with this Court's decision once the rule is established. But unless the decision below is now reviewed, no procedure gives any certainty or safety. This case, therefore, is of general public interest and importance.

WHEREFORE, your petitioners respectfully pray that writs of certiorari should be granted.

Respectfully submitted,

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